Appendix C

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COMMISSIONERS OFFICE

IN THE MATTER OF THE PETITION OF THE COUNTY OF ESSEX FOR A FRANCHISE AND APPROVAL OF CONTRACTS WITH SOLID WASTE TRANSFER AND RECYCLING INC., AND WASTE MANAGEMENT OF NEW JERSEY, INC., AND THE CO-APPLICATION OF ESSEX COUNTY AND SOLID WASTE TRANSFER AND RECYLING, INC. FOR CERTIFICATION OF PUBLIC CONVENIENCE AND NECESSITY AND FOR OTHER SUPPLEMENTAL RELIEF.	ORDER ON RECONSIDERATION
IN THE MATTER OF THE COUNTY OF	AGENCY DKT. NO. SE87070552 SE87070566
CONTINUATION OF INTERIM SOLID WASTE DISPOSAL RATES AND (2) FOR APPROVAL OF (2) FOR APPROVAL OF CUBIC YARD CONVERSION RATIO OF 3:1	OAL DKT. NO. PUC03173-88

(SERVICE LIST ATTACHED)

BY THE COMMISSIONER:

This matter is before the Department of Environmental Protection on reconsideration of an Order issued August 8,

1991 by the Board of Public Utilities ("BPU" or "Board"). That Order was the culmination of a certification and rate proceeding initiated by the County of Essex ("County") in July of 1987. On July 16, 1987, the County petitioned the Board for a Certificate of Public Convenience and Necessity ("Certificate") for two solid waste transfer stations and for approval of construction and operating contracts between the County and each of its two contract vendors: Waste Management of New Jersey, Inc. ("WM") and Solid Waste Transfer and Recycling, Inc. ("SWTR"). On July 20, 1987, the County also filed a schedule of proposed rates. Expedited interim approval of its application was requested by the County in light of the need to have the transfer stations in operation by July 31, 1987.[1] The active parties in this proceeding have been Essex County, WM, SWTR, the former Department of the Public Advocate, Division of Rate Counsel, and the City of Newark.

After lengthy hearings at the Office of Administrative Law (OAL), Administrative Law Judge (ALJ) Diana Sukovich issued a 136-page Initial Decision, dated December 26, 1990, in which she recommended that the contracts in question and the rates contained therein be adopted by the Board as reasonable. On August 8, 1991, the BPU issued its final order modifying the ALJ's determination. Briefly summarized, the BPU held that (1) the transfer station contracts had not been awarded in a normal competitive environment due to the emergent nature of the County's solid waste needs and the limited number of qualified potential transfer station operators; (2) automatic rate escalator clauses contained in the contracts, which tied rate increases to increases in the Consumer Price Index (CPI), were unreasonable in that the components of the CPI had not been shown to be reflective of changes in costs typically

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[1] The County was subject to a court imposed deadline to cease disposing of county waste at a landfill operated by the Hackensack Meadowlands District Commission (HMDC).

associated with operation of solid waste transfer stations;[2] and (3) no increase in rates above interim levels previously approved by the Board was warranted, and therefore, interim rates should be made final.

Following issuance of the Board's final order, both WM and SWTR filed motions for reconsideration. During the pendency of these motions, the Department succeeded to the duties and responsibilities of the Board in the area of solid waste regulation.

On November 13, 1992 the Department granted WM's and SWTR's motions for reconsideration. Subsequently, voluminous briefs were filed by the parties, numerous status conferences conducted, and oral arguments presented on a number of issues. The principle issues addressed by the parties were: (1) the competitive nature of the negotiations preceding the award of the contracts in question, (2) the reasonableness of automatic CPI-linked rate increases; and (3) WM and SWTR's entitlement to shortfall tonnage adjustments and Pennsylvania landfill taxes.

In addition to the above rate issues, the reasonableness of a proposed settlement between the County and WM is also at issue. The County and WM have indicated that an agreement has been reached for the payment of 8 million dollars by the County in settlement of all claims arising under the BPU's order. The County has further indicated, however, that, although it has already paid $500,000 towards the settlement amount, payment of the balance is contingent upon this Department's approval of the settlement agreement. Conversely, WM has challenged the Department's jurisdiction to review the settlement, arguing that the settlement has no impact upon ratepayers since the WM facility has ceased operations.

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[2] Although the BPU approved interim rates, it did not permit implementation of CPI increases during the pendency of the rate case.

I will first address the substantive rate case issues before discussing the proposed settlement. The position of each party is summarized as follows:

POSITION OF WM

(1) *Competitive Nature of Contract With Essex County*

WM claims that the BPU erred in finding that its contract with the County was not the result of arm's length negotiations in a competitive market. WM argues that the competitiveness of the procurement process is evidenced by: (1) the fact that the resulting rates were the lowest in the State; (2) that Essex County was immunized from possible future increases in transportation and environmental costs in excess of CPI; and (3) that the County vigorously negotiated the terms of the contract. WM also argues that the ALJ did not rely solely on a competitive market test in reaching her conclusion, but also conducted a cost-based analysis of the contract rates, further assuring reasonableness.

(2) *CPI Adjustments*

WM argues that the BPU's demand for a "nexus" between anticipated changes in transfer station operating costs and the CPI is a new standard of review, articulated for the first time in the Board's final order. WM contends that failure to advise the parties beforehand of this standard violates fundamental principles of due process. Similarly, strong objections are raised with respect to the BPU's reliance on previous decisions in which automatic escalator clauses have been rejected. With respect to the substantive merits of the CPI, WM states that the record before the ALJ demonstrates that (1) the contract rates under review are lower than rates at comparable transfer stations and therefore reasonable by comparison and (2) that actual costs over the last two years of the contract increased faster than the CPI.

(3) *Retroactive Abrogation of a Contractual Obligation*

WM argues that after it bore all risks of increased costs above CPI adjustments and after it commenced the rendering of service, the Board's order abrogated its contract rights and thus "confiscated" its property without due process. In this regard, WM contends that its contract was approved by the Board in an order dated July 31, 1987. The Board's subsequent rejection of that contract in August 1991, WM argues, violates due process requirements and sets poor public policy. The fact that a contract can be retroactively voided after substantial investment has been made and services rendered will, in WM's view, deter future participation by private industry in New Jersey's solid waste market.

(4) *Entitlement to Pennsylvania surcharges and tonnage shortfall adjustments*

WM contends that even if the BPU's Order is affirmed by the Department, that Order rejected only the CPI clause contained in the Essex County contract. All other provisions therein, such as WM's right to be reimbursed for Pennsylvania landfill taxes and tonnage ratefall adjustments, remain intact.

POSITION OF SWTR

The arguments presented by SWTR are virtually identical with respect to the above rate issues as those presented by WM. In the interest of brevity, therefore, those arguments will not be repeated here. To the extent there are minor deviations, they are addressed elsewhere in this order.

POSITION OF ESSEX COUNTY

The County argues in support of the reasonableness of the Board's August 31, 1991 final Order. At the same time, however, the County also supports the reasonableness of the proposed settlement between itself and WM. The County notes that its potential liability to WM on CPI, Pennsylvania surcharges and shortfall tonnage adjustments (without interest) totals $9,361,174. With the application of interest, that

liability, according to the County, could exceed $15,000,000. When viewed in this context the County argues that the $8,000,000 settlement amount is reasonable.

Prior to its proposed settlement agreement with WM, the County's position on the substantive issues in this case had been briefed extensively. On the main issues, the County contends that: (1) the contracts with both WM and SWTR were not negotiated in a competitive environment due to the emergent nature of the county's needs; (2) the CPI clauses are not reflective of changes in solid waste transfer station costs; (3) both WM and SWTR failed in their burden of demonstrating that the contract rates are reasonable under a rate base/rate of return analysis; and (4) the Board had an obligation to set reasonable rates independent of the negotiated contracts.

POSITION OF DEPARTMENT STAFF

Staff supports the BPU's August 31, 1991 Order. In the proceeding at the OAL, Staff took exceptions to the findings of the presiding ALJ and challenged the competitive nature of the procurement process, as well as the reasonableness of the CPI adjustment clauses. Staff further argued that neither WM nor SWTR had presented an adequate cost-based analysis upon which to base utility rates and that such failure hindered Staff in its own efforts to develop an alternative rate. Staff has taken no express position concerning the Settlement.

POSITION OF RATE COUNSEL

Initially, it should be noted that Rate Counsel's participation in the proceeding on reconsideration has been challenged by SWTR in view of Rate Counsel's failure to file exceptions to the ALJ's Initial Decision. Notwithstanding such objections, however, Rate Counsel has been permitted to present both written and oral arguments on reconsideration. I find SWTR's objections to be without merit. No case law has been presented supporting the theory that exceptions are a prerequisite to further participation. Moreover, Rate Counsel's

special status as the public representative in matters of this sort should not be lightly circumscribed.

With respect to Rate Counsel's substantive arguments, Rate Counsel urges the Department to affirm the Order of the BPU and reject the Essex County contracts. Rate Counsel argues against the position taken by WM and SWTR to the effect that the Board's Order merely rejected the CPI clauses and left other provisions of the contracts (specifically those relating to Pennsylvania taxes and shortfall tonnage adjustments) intact. Rate Counsel reasons that the contracts were found by the Board to have been negotiated in a competitive environment and therefore all provisions contained therein should be deemed rejected.

On the issue of the Board's initial implementation of the contracts, Rate Counsel argues that the July 31, 1987 Order relied upon by WM and SWTR as "final" was no more than interim in nature and clearly clearly subject to future modifications. Rate Counsel also contests the reasonableness of the CPI-linked escalator clauses and asks the Department to affirm the Board's rejection of automatic rate increases. Rate Counsel opposes the proposed settlement between WM and the County inasmuch as WM has no meritorious claim to further recovery with or without interest charges.

POSITION OF CITY OF NEWARK

The City of Newark argues in favor of the Board's Order rejecting the WM and SWTR contracts. Newark sets forth considerable case law upholding the State's right to review and modify utility contracts. Similarly, Newark exhaustively cites to numerous administrative decisions in which automatic adjustment clauses have been rejected. Newark also stresses the interim nature of the Board's July 31, 1987 Order approving the county's contracts with WM and SWTR. With respect to the competitive nature of the procurement process, Newark notes the unequal bargaining status of the parties in view of the time constraints on the County. Newark further views the record created before the OAL as inadequate to

establish a rate base/rate of return justification for the contract rates.

Newark opposes approval of any settlement between WM and Essex County absent a prior exploration of the ultimate finding mechanism and its impact upon the residents of Newark.

FINDINGS ON RATE CASE ISSUES:

I am cognizant of the thorough presentation of the issues on reconsideration made by the parties herein. Numerous briefs, letter memoranda and oral presentations give ample assurance that every party has had a more than adequate opportunity to present its case. I am also cognizant of the care with which the former Board examined the voluminous record in this matter and reached its conclusions an reflected in its August 8, 1991 Order. For the most part, my reconsideration of this matter reflects concerns identical to those expressed by the Board, most notably with respect to the CPI issue. In other areas, however, I have been persuaded on reconsideration to make certain adjustments to the Board's decision, primarily with respect to the status of the County contracts. Each area of agreement or modification is dealt with separately below.

(1) *CPI Based Automatic Increases:*

I am in complete agreement with the Board's rejection of the CPI-based automatic increases sought by WM and SWTR. There are fundamental problems with automatically linking rate increases at solid waste transfer stations to the CPI. The major components of transfer station costs are depreciation, landfill disposal hosts, transportation costs, return on investment and salaries. The major components of the CPI relate to food, housing and electronic goods and thus bear little relationship to increases in costs associated with the solid waste industry.

Well-established regulatory policies and law provides that rate increases would not be based upon CPI escalators. Reflecting this policy, New Jersey's ratemakers have consistently refused to recognize increases associated with general

inflationary factors." See *Petition of Elizabethtown Water Company*, 11 *A.J.A.R.* 303, 337 (OAL 2994), reversed on other grounds, 205 *N.J. Super.* 528 (App. Div. 1985). affirmed as modified, 107 *N.J.* 440 (1987). See *Re Jersey Central Power & Light Co.*, 65 *PUR* 45th 175 (*N.J.* B.P.Y. 1985); *Re Commonwealth Water Company*, 21 *PUR* 4th 254, 273-274 (S.D.P.U.C. 1977) (The effects of inflation on a company do not in any reasonably accurate manner parallel those contained in the CPI.) in *Elizabethtown Water Co.*, *supra*, the Board rejected a general 4% inflationary increase in the calculation of expenses. In *Jersey Central Power and Light Co.*, *supra*, the Board rejected a proposed use of the CPI in a utility's calculation of future costs of decommissioning a nuclear generating station, stating that the CPI did not accurately reflect the true cost of decommissioning because it did not truly quantify petitioner's projected labor costs." 65 *PUR* 4th at 178.

Only when an automatic adjustment clause has been specially selected to reflect the type costs under review, has its use been permitted. In *Application of SES Gloucester Company*, the Board approved a 20-year utility rate formula for a resource recovery facility that included a formula for annual adjustments based upon changes in the Producer Price Index (PPI). The use of this clause, however, was specifically linked to further Board review of each increase. In contrast, the CPI clauses here (1) were not tailored in any way to reflect transfer station costs and (2) were not subject to any further ratemaking review or analysis.[3]

Equally well-established is the fact that the burden of proving every aspect of a rate's reasonableness is upon the utility. See *Public Service Coordinated Transport of New Jersey v. State* 5, *N.J.* 196, 219 (1950); *In re Application of*

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[3] New Jersey is not alone in this guarded approach to automatic rate adjustments. Other jurisdictions have similarly rejected automatic CPI adjustment clauses or similar inflationary adjustments. *See i.e.*, *Re Otter Tail Power Co.*, 21 *P.U.R.* 114th 254 (S.D. P.U.C. 1977).

Saddle River, 71 *N.J.* 14, 25-26 (1976). Consequently, requiring a solid waste utility to demonstrate a "nexus" between transfer station cost components and the CPI is far from the articulation of a "new" standard, as argued by WM and SWTR. Rather, such a requirement does no more than hold WM and SWTR to their burden of proving the reasonableness of their proposed rate. I therefore reject arguments raised by WM and SWTR to the effect that the Board's reliance upon previous cases relating to automatic adjustment clauses was somehow unexpected and a denial of due process. Accordingly, because WM and SWTR have failed to create a record supporting the reasonableness of automatic CPI-based rate increases, I *AFFIRM* the Board's rejection of these increases.

I similarly reject arguments by WM and SWTR to the effect that denial of CPI increases after services have been rendered constitutes a violation of due process. Those who do business in a regulated environment are deemed to know that their agreements are subject to the overriding supervision of the regulatory authority.

Courts have long recognized that parties operating in regulatory environments are aware that the agreements they reach are subject to the overriding jurisdiction of the regulating agency. Thus,

> Every contract with respect to utility rates is conclusively deemed to be made with knowledge and in contemplation of the sovereign power of the state to alter it, and hence no objection can be raised that state regulation impairs the obligation of contract or deprives the contracting parties of property without due process of law . . . [73B *C.J.S.* "Public Utilities" at 164]

This longstanding principle was acknowledged in *New Jersey Suburban Water Co. v. Riordan*, 4 *N.J. Misc.* 256 (Sup. Ct.) aff'd 103 *N.J.L.* 498 (E & A 1926), where the Court stated:

> Since the adoption of the Public Utilities Act of 1911, a contract between a municipality and a water company, fixing the rate to be charged for service, imposes no restrictions on the sovereign power of the State to fix just and reasonable rates as subsequent conditions may make desirable, and when the state, through its Board of Public Utility Commissioners, exercises its sovereign power over rates, the contract rights of the parties must yield (4 *N.J.* Misc. at 259]

With specific reference to publicly bid municipal contract for solid waste utility services, our Supreme Court in *In Re Saddle River*, 71 *N.J.* 14 (1976), ruled that:

> Such contracts, although their provisions are agreed upon by the parties, are nevertheless subject to modification by the Board of Public Utility Commissioners in the public interest. [71 *N.J.* at 23]

Indeed, this agency is vested with broad authority over all aspects of solid waste collection and disposal under *N.J.S.A.* 48:13A-1 *et seq*. The Legislature has declared that the disposal of solid waste "is a matter of grave concern to all citizens and . . . thoroughly affected with the public interest." *N.J.S.A.* 48:13A-2. Having succeeded to all powers vested in the former BPU, the Department is statutorily charged with "the duty of setting and enforcing solid waste disposal standards and rates for regulating the 'economic aspects' of all solid waste disposal services." *N.J.S.A.* 48:13A-2. Upon complaint or on its own initiative the Department may direct "any person engaging in the solid waste disposal business to furnish proof that the rates or charges received for solid waste disposal services do not exceed just and reasonable rates or charges for such service." *N.J.S.A.* 48:13A-7(a). In the event rates or charges are excessive, the Department may order "an adjustment in the tariff or contract to a sum which shall result in just and reasonable rates or charges." *N.J..S.A.* 48:13A-7(b). The parties to the contracts at issue here knew fully that their interaction was subject to such regulatory jurisdiction.

I also find no merit in the reliance placed by WM and SWTR upon the Board's July 31, 1987 initial order implementing the service contracts. The Board's implementation of these service contracts was emergent, interim in nature, and clearly subject to future modifications at the close of the rate proceeding. If this were not the case, it is difficult to ascertain what purpose further rate proceedings would have served.

(2) *Status of Contracts*

In her initial Decision, the presiding ALJ specifically found that the County's contracts were the result of an arms' length competitive procurement process. In its August 8, 1991 Order, the Board reversed this finding, reasoning that the emergent solid waste needs of the County and, in the Board's view, the limited number of available vendors, rendered the negotiation process less than competitive. For such reason, the Board rejected the contracts and proceeded to set independent service rates.[4]

The degree to which the Court-imposed deadline may or may not have influenced County's negotiation strategy is an issue over which reasonable persons may legitimately differ. Similarly, the intensity of the County's negotiation efforts and the adequacy of the pool of potential vendors (both in terms of qualifications, numbers and interest) can also be the subject of reasonable but differing views. In the present case, I am persuaded by the analysis of the presiding ALJ with respect to the competitive nature of the procurement process and the efforts the County made to secure the best deal possible. As the

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[4] SM and SWTR have argued that the Board's order did not reject the contracts in their entirety, but simply rejected the CPI clauses contained therein. In support of this proposition, reliance is placed upon language in the Board's order which refers to revision of the "contract" rate. As I read the order, it is clear that the Board rejected the contract in its entirety based upon its belief that the negotiation process was not sufficiently competitive. The reference to revision of the "contract" rate appears to refer merely to the starting point for the Board's independent rate computation.

presiding ALJ, it was she who had the opportunity to hear the witnesses describe the negotiation process, the rating system the County used in evaluating candidates, and the overall tenor of meetings and discussions. I find no fault with her conclusion, therefore, that based upon the record presented to her there existed no reason to believe that the negotiation process was less than competitive.

For such reason, based upon the record developed before the ALJ, I *FIND* that the contracts in question were the result of competitive negotiations. Such finding does not detract in any way, however, from this Department's jurisdiction to modify said contracts so as to eliminate the CPI clauses as sat forth above. As previously stated, utility contracts are deemed entered into with full knowledge of the overriding jurisdiction of the regulating authority.

(3) *Tonnage Adjustments and Pennsylvania Landfill Taxes*

Having found the contracts in question to be the result of arms-length competitive bidding and having modified such contracts only to the extent of eliminating automatic CPI adjustments, other contract provisions relating to the recovery of shortfall tonnage adjustments and landfill taxes remain intact. The record before me supports a finding that, with respect to WM, there exists $4,841,930 in shortfall tonnage adjustments over the life of the contract and $1,065,746 in landfill taxes. I *FIND* these amounts reasonable and approve recovery by WM. I reject, however, WM's claim of entitlement to interest on such amounts. WM cites no case law supporting the award of interest in a rate proceeding.

With respect to SWTR's alleged entitlement to shortfall tonnage adjustments, the SWTR and WM contracts treated this issue differently. Whereas the WM contract obligated the County to direct a tonnage to the facility ("Guaranteed Tonnage") the SWTR contract merely set different rates which varied upon the average daily tonnage and were subject to correction in two six-month increments. In addition, the adjustment was available only during the "interim emergency

service period" which spanned August 1, 1987 to August 1, 1988. Further, any claims for shortfall tonnage adjustment entitlement were to be made by SWTR two days from the end of both six-month periods within the interim emergency services period and remittance was to occur within the preceding six months. Essex County has stated unequivocally that no such claims were presented by SWTR in a timely manner and SWTR has been unable to provide invoices showing tonnage shortfalls. The County also objects to SWTR raising an alleged entitlement to recovery of these adjustments at this late date. (See September 10, 1993 and September 14, 1993 letters from Michael Caro, Esq. to former Commissioner Fox on behalf of the County). SWTR's claim to recovery of landfill taxes is similarly unspecified. Given the untimely and unsubstantiated nature of SWTR's claims, such claims are *DENIED*.

In conclusion, the August 8, 1991 Order of the former Board of Public Utilities in this matter is *HEREBY MODIFIED* upon reconsideration to the extent set forth above. In light of my decision, the proposed eight million dollar settlement between Essex County and WM is *REJECTED*.

/s/ Robert C. Shinn

Robert C. Shinn
Commissioner Department of
Environmental Protection
and Energy

DATED: AUG 23, 1994